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A competition policy and efficient regulatory framework for the port sector: *getting it unberthed*

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The Philippines is an archipelago of approximately 7,107 islands. Maritime transport is the major means by which the islands are connected and the movement of commodities and people facilitated. The Philippines is primarily linked to the international trade system via maritime transport. Almost 98 percent of materials and products imported and exported by the country are facilitated through maritime exchanges (Innovation Norway 2004).

The archipelagic arrangement requires an efficient maritime transport infrastructure for growth and socioeconomic integration. The integration of peripheral islands to the urban economic nodes such as the cities of Metro Manila, Cebu, Davao and General Santos and the diffusion of investments and economic activities fundamentally count on an efficient road and maritime transport network.

However, the country's inefficient maritime transport has been an effective barrier to domestic and international trade integration. The high cost of transporting people and goods has stymied countryside development and has eroded the competitiveness of exports. As much as 40 percent of predicted transport costs for coastal countries like the Philippines may be explained by the quality of onshore infrastructure accounts.[1] Table 1 compares the relative efficiency of Philippine ports handling foreign trade with those of the leading Asian ports and shows the country to be the least efficient. The inefficiencies stem from (a) inadequate port and

[1] Limao and Venables (2000).

PIDS Policy Notes are observations/analyses written by PIDS researchers on certain policy issues. The treatise is holistic in approach and aims to provide useful inputs for decisionmaking.

This *Notes* is based on PIDS Discussion Paper Series No. 2005-02 titled "Competition policy and regulation in ports and shipping" by G. Llanto, E. Basilio and L. Basilio. The author is Vice-President, PIDS and Research Fellow, Rural Development Research Consortium, University of California, Berkeley. The views expressed are those of the author and do not necessarily reflect those of PIDS or any of the study's sponsors.

Table 1. Indicators of port efficiency

Country	Port Efficiency Index (1-7)	Median Clearance Time (Days)
Hong Kong	6.38	na
Malaysia	4.95	7
Philippines	2.79	7
Singapore	6.76	2
Taiwan	5.18	na

Notes:
Port efficiency index is from the Global Competitiveness Report, 7 being the best score;
Median Clearance Time is the median number of days to clear customs;
Data for year 2000.

vessel capacities; (b) ineffective port management and administration; and (c) constraints arising from anti-competitive policies and regulation.

This *Policy Notes* highlights the importance of a competition policy and an efficient regulatory framework of the port sector to help resolve these inefficiencies, ensure adequate returns to investors and safeguard consumer welfare. It also identifies some outstanding issues in the port sector that need to be addressed for policy and institutional reform.

Importance of a competition policy and efficient regulation

Policymakers have to understand the importance of a competition policy and efficient regulation in the infrastructure and utilities sector.

The government faces the challenge of establishing a competitive framework in the port sector and other sectors and having a degree of regulatory restraint on private providers that would not unnecessarily stifle investments and innovations. The policy challenge is to find the right combination of regulation and openness to potential competition...

Competition policy and market-enhancing regulation can motivate private sector investments in better-equipped vessels and ports that support value-added logistics services. They also help ensure the protection of consumers from the exercise of market power. Competition encourages entry of other firms thereby opening the industry to better and lower-priced service. Under a competitive environment, rival firms try to outdo each other by offering lower prices and better quality service in a bid to capture a greater market share. Competition also provides incentives to firms to reduce costs and innovate for increased profits. It tends to limit collusive behavior in the industry and makes possible the transfer of rents to consumers, thereupon serving the latter's interest.

The government faces the challenge of establishing a competitive framework in the port sector and other sectors and having a degree of regulatory restraint on private providers that would not unnecessarily stifle investments and innovations. The policy challenge is to find the right combination of regulation and openness to potential competition that would motivate private investors to provide lumpy investments in long-lived assets. Said investors, after all, want the assurance of having adequate returns to their risk capital.

While competition is preferred to regulation, it may be necessary to unbundle industries into competitive and noncompetitive segments for the purpose of effective regulation. The policy may be to leave the competitive segment to market forces and to delimit regulation to the segment or segments where competition is not feasible and monopoly elements are in play. For instance, ownership of ports could be monopolistic but other port services such as cargo handling could be competitively provided by more than one operator. Where the scope for competition is substantial and there is contestability of markets, there may be little need for regulation as, for example, in shipping and cargo handling services.

Vertical integration of competitive and noncompetitive segments complicates the regulatory framework. Undue regulatory intervention in the potentially competitive segment gives rise to inefficiencies and a lower level of welfare. Thus, the government has to find the right competition policy and regulatory design that would maintain a balance between investor interest and consumer welfare.

The Philippine port system

The Philippine port system, as shown in Figure 1, has four categories: (a) the Philippine Ports Authority (PPA) port system consisting of public and private ports; (b) ports under the jurisdiction of independent port authorities (IPAs); (c) public ports devolved to the local government units (LGUs), including fishing ports and wharves; and (d) the recently established Road Roll-On Roll-Off (RORO) terminal system (RRTS).

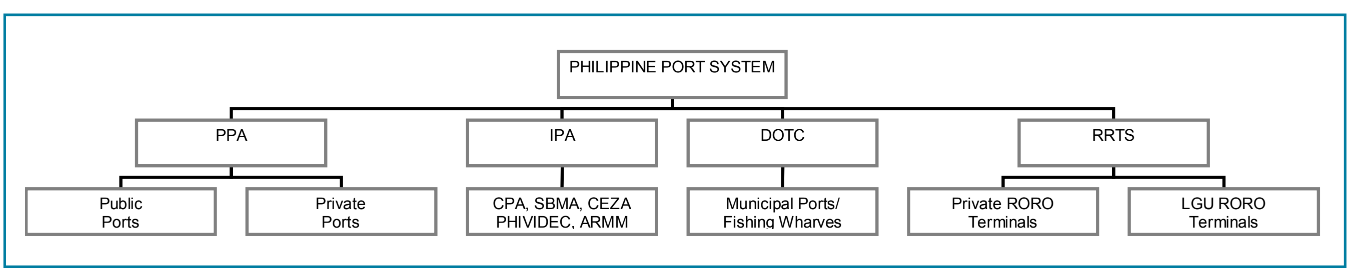
The PPA port system is the most important and extensive network of ports in the country.[2] It consists of 115 PPA-owned ports and over 500 private (commercial and noncommercial/industrial) ports under its direct supervision. Private ports are mostly for industrial use although there are some that operate for commercial purposes. There are around 30 private commercial ports, e.g., Allen Port in Samar, San Lorenzo Port in Guimaras, Tefasco Port in Davao and Bredco in Bacolod. Private commercial ports rarely provide competition to PPA ports, with the possible exception of the Harbor Center Port Terminal Incorporated (HCPTI), a private commercial port established in 1996 that competes with PPA-owned South Harbor and North Harbor in Manila.

Recent policy and institutional reforms in the port sector augur well for economic growth and socio-economic integration. Using the 'landlord' model for port management and administration, the government has introduced some form of competition in major ports...

The PPA is financially autonomous from the government. It earns revenues from (a) concession fees from the lease of South Harbor and the Manila International Container Terminal (MICT); (b) port charges such as wharfage, berthing and pilotage, among others; and (c) a share of cargo handling revenues from private cargo-handling operators and from port charges of privately-operated ports. A 1992 law mandates it to remit 50 percent of its net income as dividends to the national government. Its ports handle domestic and foreign cargo (containerized and bulk) and passengers. Some PPA-owned ports also allow for RORO operations.

[2] PPA was established in 1974 and is a government corporation mainly concerned with the planning and development of seaports in the country. Most ports, especially the large ones, are under the control of PPA.

Figure 1. The Philippine port system



Recent policy and institutional reforms

Recent policy and institutional reforms in the port sector augur well for economic growth and socioeconomic integration.[3] Using the 'landlord' model for port management and administration, the government has introduced some form of competition in major ports such as the Manila International Container Terminal, and South and North Harbors in Manila through concessions with the private sector.[4] The government has also launched the RRTS through Executive Order (EO) 170 issued in 2003 to provide an efficient nautical highway for transport and commerce. EO 170 calls for private sector and local government collaboration in the establishment of RORO links as part of the national highway network. The RORO has distinct advantages over the usual load on-load off practice (Box 1).

EO 170 likewise mandates the privatization and/or devolution of existing public RORO ports under the PPA or Cebu Ports Authority. It also encourages existing private port operators to convert their operations to RORO. To bankroll the development of RORO shipping, the Development Bank of the Philippines has opened a lending window called the Sustainable Logistics Development Program (SLDP). Eligible projects for funding are: RORO vessel acquisition, RORO port construction, investment in bulk-handling of agricultural commodities and cold chain facilities.

In addition, EO 170 provides a scope for the participation of local governments and private investors in developing the nautical highway to meet both private (e.g., business and profits) and public objectives (service to the public, consumer welfare).

[3] There are also reforms in the shipping sector, e.g., deregulation of shipping services, but this *Policy Notes* only discusses the issues in the port sector because of space limitation.

[4] In this model, port infrastructure is owned by the port authority (government) but is leased to private operating companies and/or industries. The private port operators provide and maintain their own superstructure including buildings, cranes, vans and forklifts. The port authority acts largely as a regulator and landlord, while port operations are carried out by the private sector. This model is increasingly becoming popular in large and medium-sized ports worldwide (UNESCAP 2001).

Box 1. Advantages of the RORO

- No cargo handling charges since the cargo is "rolling;"
- No wharfage dues (specified under EO No.170);
- Unbundled (and transparent) toll fee consisting of (a) terminal fee charged on the self-powered vehicle and passengers for the use of the terminal; (b) berthing fee levied on the RoRo vessel by the terminal operator for mooring and berthing; (c) freight or rolling cargo fee, based on the lane meter or the actual space occupied by the vehicle, charged to the rolling cargo by the carrier vessel operator; and (d) passage fee levied to the passengers by the RoRo vessel operator;
- Simplified documentary requirements, and
- Waiver of port authorities' share in revenues, with PPA and MARINA receiving a fixed annual administrative supervision fee.

Some outstanding issues

Albeit the positive developments in the policy and institutional aspects, there still remain a number of outstanding issues in the port sector that have to be looked into more closely.

Among these are:

Conflicting roles of PPA. The Philippine port system basically gravitates around the PPA port system. PPA has multiple roles as a developer, operator, owner and regulator of ports. It regulates private ports, awards contracts for cargo handling services to the private sector in ports owned by it and regulates entry of the private sector through the issuance of permits to construct and operate ports. The highly centralized port ownership and administration leads to conflict of functions and interest problems.

Limited competition. This setup disadvantages non-PPA ports and leads to limited competition in the industry. PPA, as port regulator and port owner, issues permits to private companies to construct and operate ports. This setup creates the wrong incentive for PPA which may not approve the private sector's application for construction or expansion if this threatens PPA's port ownership and revenues. In 1997, PPA issued a regulation liberalizing the construction and operation of private industrial ports but not its operation for commercial purposes.

Benefit from own regulation. PPA's Charter (Presidential Decree 857) allows it to have a share of at least 10 percent from cargo handling revenues. PPA regulates and approves tariffs and rate increases in port charges and cargo handling rates for both public and private ports, putting it in a potential conflict of interest situation because higher cargo handling rates given to private port operators result in a higher share of the revenues to PPA which regulates rate setting. This is a case of a regulator benefiting from its own regulation.

Conclusion and recommendation

The inefficiencies in port operations and administration are partly due to flaws in port policy and the regulatory design. These flaws have led to very limited competition and private sector participation.

Because of flaws in policy and regulatory design, a restructuring is indispensable. There is a reason to review PPA's charter and amend it to separate PPA's regulatory responsibilities from ownership, development and operation functions. The amendment may call for the establishment of an independent port regulator that would ensure efficiency in port operation and the upholding of consumer welfare. The review should consider the crucial role played by both the government and the private sector in the development and operation of ports. It must take into account the need for a clear delineation of the respective roles of government and the private sector which can draw from an appreciation of relative comparative advantages, e.g., government taking an enabling role and private sector owning and operating ports. The review, however, should also consider the social goal of developing port infrastructure in less developed regions of the country.

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